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Committee on Fiscal Resource

Senator Jim Horne, Chairman

FEASIBILITY OF EXEMPTING ALL S. 501(C)(3) ORGANIZATIONS FROM FLORIDA'S SALES AND USE TAX

SUMMARY

Nonprofit organizations holding section 501(c)(3) status is insufficient under Florida law to qualify an entity for exemption from Florida's sales and use tax. However, many of Florida's sales and use tax exemptions do currently require that an organization hold section 501(c)(3) status as one of several requirements, all of which must be met, in order to qualify for exemption. Every year, the Florida Legislature spends significant time and effort to provide sales and use tax exemptions to section 501(c)(3) organizations that have been denied a consumers' certificate of exemption. The purpose of this report is to evaluate the feasibility of exempting all section 501(c)(3) organizations from Florida's sales and use tax. Current sales tax exemptions offered section 501(c)(3) organizations and dates enacted are listed along with a five year list of proposed legislation to exempt section 501(c)(3) organizations from the state sales and use tax. The report also looks at the number and types of section 501(c)(3) organizations denied Florida sales tax exemption. In addition, a list of states which exempt purchases by organizations exempt under section 501(c)(3) is provided.

educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals . . .

Florida provides a number of sales tax exemptions based on the perceived nature of an organization as supplying goods or services that are beneficial to the public or promote a socially desirable goal. Such entities include nonprofit organizations considered charitable, educational, and religious. Nonprofit organizations holding section 501(c)(3) status is insufficient under current Florida law to qualify an entity for exemption from Florida's sales and use tax. However, many of Florida's sales and use tax exemptions do currently require that an organization hold section 501(c)(3) status as one of several requirements, all of which must be met, in order to qualify for exemption. Every year, the Florida Legislature spends significant time and effort to provide sales and use tax exemptions to section 501(c)(3) organizations that have failed to meet one or more of the myriad of requirements for exemption under Florida law. In addition, it is difficult for taxpayers to understand why they do not qualify for state sales tax exemption when they qualify for federal income tax exemption.

BACKGROUND

Nationally, there are more than one million groups recognized by the IRS as nonprofit organizations. They include social welfare organizations, social and recreational clubs, employee pension funds, religious organizations, business leagues, and credit unions. These diverse organizations are all nonprofit, but only about half (600,000 organizations in 1994) had charitable, tax-exempt status under section 501(c)(3) of the Internal Revenue Code (IRC).

Section 501(c)(3) of the IRC exempts from the federal corporate income tax, corporations and associations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or

METHODOLOGY

Information for this project was obtained in a number of ways. First, federal and state statutes were researched to determine criteria for exemption. Next, a legislative history of s. 212.08(7), F.S., as it pertains to section 501(c)(3) organizations, was performed along with all proposed section 501(c)(3) legislation over the past five legislative sessions. Information was obtained from the Department of Revenue on the following topics: section 501(c)(3) organizations denied a Florida sales tax exemption for failure to meet all statutory requirements; growth in the number of section 501(c)(3) organizations since 1994; estimated annual cost to administer the consumers' certificate of exemption program; and the revenue estimate of exempting all section 501(c)(3) organizations from the sales tax. The report also looks

at other states that provide a sales tax exemption by cross-referencing the federal exemption.

FINDINGS

The Florida Legislature provides sales and use tax exemptions to many nonprofit organizations. Since the inception of the state sales tax in 1949, the Florida Legislature has provided a sales tax exemption to over thirty-five nonprofit, section 501(c)(3) organizations, primarily religious, charitable, educational, scientific, and veterans' organizations. Each new exemption requires action by the Legislature. A bill is filed and referenced to several legislative committees. If placed on a committee agenda, an analysis is performed by legislative staff and the bill is heard by the committee. Once the bill is favorably considered, it is sent to the next committee of reference and the process begins again. If placed on the Special Order Calendar, the bill is available for floor discussion, open to amendments, and can be voted on for passage. If passed, the bill is sent to the other chamber for similar action.

In addition to the thirty-four, section 501(c)(3) exemptions passed by the Legislature since 1978, there have been numerous bills filed each year proposing new sales tax exemptions for worthy section 501(c)(3) organizations. Between 1995 and 1999, the Legislature dealt with thirty-one such proposed exemptions, resulting in fourteen becoming law.

Generally speaking, when legislation is proposed to exempt a section 501(c)(3) organization, it is the result of the Department of Revenue denying the organization a Consumers' Certificate of Exemption because the organization did not meet all of the state requirements for exemption. There are many worthy organizations denied exemption each year. It is difficult for these organizations to understand why they do not qualify for exemption from state sales tax when they qualify for exemption from federal income tax as a result of having undergone IRS scrutiny. Such denials can result in bad feelings on the part of the taxpayer towards the Department, even though the Department is just implementing the law. Between 1996 and 1999, there were twenty-three section 501(c)(3) organizations denied exemption for failure to meet statutory requirements and which brought suit against the Department of Revenue.

In a year, the Department of Revenue denies approximately 350 section 501(c)(3) applications for exemption. Each of these entities was denied because one or more of the numerous statutory criteria was not

met. In addition to the twenty-three litigated cases, between October, 1998 and March, 1999, section 501(c)(3) organizations engaged in the following activities were denied an exemption:

- C advocated for persons with disabilities
- C educated the public on health and well-being issues
- C educated the public on issues concerning animals
- C funded activities for minors
- C funded other "fundraiser" groups (1999 Legislature exempted in HB 561)
- C funded conservation education
- C fulfilled the desires of terminally ill children
- C provided volunteers for other nonprofit organizations
- C supports a county-operated public park

The number of active section 501(c)(3) Consumers' Certificates of Exemption (CEX) accounts have grown by thirty-seven percent over the past five years. The Department of Revenue expends considerable resources determining whether organizations qualify for exemption under the complex definitions of "religious", "charitable", "scientific", and "educational" in paragraph (o) of section 212.08(7), F.S., and resolving disputes on that issue. The Department estimates the cost to administer the consumers' certificate of exemption program to be \$281,622 annually. The \$281,622 is composed of the following:

- C Processing applications: The average cost to process an application for exemption, approval or denial, is estimated to be \$23.32. The Department processed 8,826 new and renewal applications in 1998 for a total cost of approximately \$ 205,822.
- C Litigation expenses: In 1996, the department attended 21 Department of Administrative Hearings (DOAH), in 1997, 13 DOAH hearings, and in 1998, 19 DOAH hearings. The costs per year have been approximately \$75,800, which covers attorney time, attorney travel expenses, travel expenses for the witnesses, and administrative expenses.

Thirteen states give sales tax exemptions for purchases by organizations that hold section 501(c)(3) status either by cross-referencing section 501(c)(3) or by exempting an identical or nearly identical list of organizations. Exemption by cross-reference to section 501(c)(3) offers the broadest protection to nonprofit charitable, educational, and religious organizations. It also benefits states by reducing the administrative burden of processing exemption applications.

The Revenue Estimating Conference (REC) estimates the fiscal impact of proposed legislation. In 1998 and 1999, the REC provided revenue estimates for proposed legislation to exempt all section 501(c)(3) organizations. The Department of Revenue, Office of Research and Analysis did extensive work on the 1998 REC estimate in order to produce a more accurate portrayal of the fiscal impact of exempting all section 501(c)(3) organizations from the sales tax. As a result, the analysis based on the 1999 legislation estimated a recurring General Revenue loss of \$23.8 million, with a loss to local governments of \$2.2 million in the half-cent sales tax and \$1.5 million in local option sales tax revenue, and a loss to the Solid Waste Management Trust Fund of \$0.1 million.

RECOMMENDATIONS

Since the inception of the state sales tax in 1949, the Florida Legislature has provided a sales tax exemption to over thirty-five nonprofit, section 501(c)(3) organizations, primarily religious, charitable, educational, scientific, and veterans' organizations. Nonprofit organizations holding section 501(c)(3) status is insufficient under Florida law to qualify an entity for exemption from Florida's sales and use tax. However, many of Florida's sales and use tax exemptions do currently require that an organization hold section 501(c)(3) status as one of several requirements, all of which must be met, in order to qualify for exemption. Every year, the Florida Legislature spends significant time and effort to provide sales and use tax exemptions to section 501(c)(3) organizations that have been denied a consumers' certificate of exemption by the Department of Revenue because the organization did not meet all of the state requirements for exemption. As presented in this report, many section 501(c)(3)

organizations are denied exemption even though they provide necessary services to those in need. Between 1995 and 1999, the Legislature dealt with thirty-one such proposed exemptions, resulting in fourteen becoming law. In addition, it is difficult for taxpayers to understand why they do not qualify for state sales tax exemption when they qualify for federal income tax exemption. As a result of the denial of exemption for section 501(c)(3) organizations, some of the organizations spent considerable resources filing suit against the Department of Revenue contesting their denial, and in response, the Department spends an estimated \$75,000 annually in litigation expenses. Twenty-three organizations filed suit against the Department between 1996 and 1999.

There are both costs and benefits associated with exempting all section 501(c)(3) organizations. The costs would be a recurring General Revenue loss of \$23.8 million. The benefits would be: easing current administrative burdens and lowering annual administrative costs; providing exemptions to worthy nonprofit organizations; good will between the Department of Revenue and the taxpayer; and major reductions in annual legislation filed.

Based on the findings of this report, it is the recommendation of the Fiscal Resource Committee that the Legislature consider exempting all section 501(c)(3) organizations from the state sales and use tax. The extrinsic benefits to the taxpayers and the State of Florida from exempting all section 501(c)(3) organizations outweigh the monetary costs to the General Revenue Fund.

COMMITTEE(S) INVOLVED IN REPORT *(Contact first committee for more information.)*

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MEMBER OVERSIGHT

Senators Forman and Grant